

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Date:

May 19, 2008

Legend

Date X =

Date Y =

Corporation =

Business A =

Business B =

Distributing =

Controlled =

Distributing LLC =

Controlled LLC =

Stock Option Plan =

Stock Incentive Plan =

Dear :

This letter responds to a letter dated July 16, 2007, and subsequent correspondence, submitted by your authorized representatives, requesting rulings under various sections of the Internal Revenue Code (Code). This letter addresses your requested rulings under sections 83 and 424 of the Code. A related letter was issued

on Date X. The facts, as represented in your original and supplemental submissions, are set forth below. The transaction (Transaction) described in the submissions was completed on Date Y.

As described in the submissions, Corporation was a publicly-held company and the common parent of an affiliated group of corporations filing a consolidated Federal income tax return. Corporation was directly engaged in Business A and Business B. Corporation had one class of common stock outstanding. The purpose of the Transaction was to separate, for valid business reasons, the two business lines in a spin-off transaction.

Distributing, Controlled, Distributing LLC and Controlled LLC were newly formed for purposes of the Transaction. Distributing had one class of common stock, all of which was held by Corporation. Controlled had one class of common stock, all of which was held by Distributing. All of the membership interests of Distributing LLC were held by Corporation and all of the membership interests of Controlled LLC were held by Distributing. Distributing LLC and Controlled LLC were disregarded as entities separate from their owners for Federal income tax purposes.

Pursuant to the Transaction, Corporation merged with and into Controlled LLC with Controlled LLC surviving the merger. In the merger, each share of Corporation common stock was exchanged for one share of Distributing common stock. Following the merger, Controlled LLC contributed Business A to Distributing LLC and distributed all of its interests in Distributing LLC to Distributing. Distributing then transferred all of its interests in Controlled LLC to Controlled. Following such transfers of interests, Distributing LLC incurred certain indebtedness from third party sources and contributed a portion of the proceeds to Distributing. Distributing contributed a portion of such proceeds to Controlled, then distributed, pro rata, all of the common stock of Controlled to holders of record of Distributing common stock (Share Distribution). After the foregoing, Distributing owned Business A and Controlled owned Business B, with employees of Business A being employees of Distributing and employees of Business B being employees of Controlled. With one exception, each director of Corporation became a director of either Distributing or Controlled. One director of Corporation became a director of both corporations.

Prior to the Transaction, Corporation maintained the Stock Option Plan and the Stock Incentive Plan. Pursuant to the Stock Option Plan and the Stock Incentive Plan, Corporation granted certain of its employees and directors options to purchase shares of Corporation's common stock. As a result of the Transaction, each incentive stock option (Corporation ISO) and non-statutory option (Corporation Non-Statutory Option) held by an employee or director immediately before the Share Distribution was converted into a corresponding incentive stock option or non-statutory stock option to acquire either Distributing common stock (Distributing ISOs or Non-Statutory Stock Options, as applicable) or Controlled common stock (Controlled ISOs or Non-Statutory

Stock Options, as applicable). Consequently, employees and directors of Distributing received Distributing ISOs or Non-Statutory Options (collectively Distributing Options) and employees and directors of Controlled received Controlled ISOs or Non-Statutory Options (collectively Controlled Options). Each Distributing or Controlled Option received as a result of the Transaction had the same terms and conditions as the corresponding Corporation ISOs and Non-Statutory Options (collectively Corporation Options), except that appropriate adjustments were made by reason of the Transaction.

Corporation makes the following representations. None of the Corporation Non-Statutory Options had a readily ascertainable fair market value within the meaning of section 1.83-7(b) of the Income Tax Regulations (Regulations) at the time the options were granted. None of the Distributing or Controlled Non-Statutory Options had a readily ascertainable fair market value within the meaning of section 1.83-7(b) of the Regulations at the time the options were granted. The conversion of Corporation ISOs to Distributing and Controlled ISOs, as described above, was consistent with section 424 of the Code and Regulations issued thereunder, and Corporation specifically represents that the requirements of section 1.424-1(a) of the Regulations are satisfied. Pursuant to a tax allocation agreement, Distributing and Controlled will each only claim a deduction for compensation income recognized by its own employees and directors.

Section 83(a) of the Code provides that if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of (1) the fair market value of such property (determined without regard to any restriction other than a restriction that by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 83(g) of the Code provides that if property to which section 83(a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege, (1) such exchange shall be disregarded for purposes of section 83(a), and (2) the property received shall be treated as property to which subsection (a) applies.

Section 83(h) of the Code provides that, in the case of a transfer of property to which section 83 applies, there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a),

(b) or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services. Section 3.01(6) of Revenue Procedure 2007-3 provides that the Internal Revenue Service will not issue a letter ruling regarding which corporation is entitled to the deduction under section 83(h) of the Code in cases where a corporation undergoes a corporate division if the facts are not similar to those described in Revenue Ruling 2002-1, 2002-2 I.R.B 268.

Section 1.83-1(b)(1) of the Regulations provides that if substantially nonvested property is subsequently sold or otherwise disposed of to a third party in an arm's length transaction while still substantially nonvested, the person who performed the such services shall realize compensation in an amount equal to the excess of (1) the amount realized on such sale or other disposition, over (2) the amount (if any) paid for such property. Under section 1.83-1(b)(3) of the Regulations, section 1.83-1(b)(1) shall not apply to, and no gain shall be recognized on, any sale, forfeiture or other disposition to the extent that any property received in exchange therefore is substantially nonvested. Instead, section 83 of the Code and section 1.83-1 of the Regulations shall apply with respect to such property received (as if it were substituted for the property disposed of).

Section 1.83-7 of the Regulations provides that, if there is granted to an employee or independent contractor in connection with the performance of services, an option to which section 421 of the Code does not apply, section 83(a) of the Code shall apply to such grant if the option has a readily ascertainable fair market value at the time the option is granted. The person who performed such services realizes compensation upon such grant at the time and in the amount determined under section 83(a) of the Code. If section 83(a) of the Code does not apply to the grant of such an option because the option does not have a readily ascertainable fair market value at the time of grant, sections 83(a) and (b) of the Code shall apply at the time the option is exercised or otherwise disposed of, even though the fair market value of such option may have become readily ascertainable before such time. If the option is exercised, sections 83(a) and (b) of the Code apply to the transfer of property pursuant to such exercise, and the employee or independent contractor realizes compensation upon such transfer at the time and in the amount determined under sections 83(a) and (b) of the Code. If the option is sold or otherwise disposed of in an arm's length transaction, sections 83(a) and (b) of the Code apply to the transfer of money or other property received in the same manner as those sections would have applied to the transfer of property pursuant to an exercise of the option.

Section 424(a) of the Code provides that the term "issuing or assuming a stock option in a transaction to which section 424(a) applies" means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation reorganization or

liquidation, if (1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and (2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

Section 424(h)(1) of the Code provides that if the terms of any option to purchase stock are modified, extended or renewed, such modification, extension or renewal shall be considered the granting of a new option.

Section 424(h)(3) of the Code provides, in part, that the term "modification" means any change in the terms of the option that gives the employee additional benefits under the option, but such terms shall not include a change in the terms of the option attributable to the issuance or assumption of an option under section 424(a).

Section 1.424-1(a) of the Regulations provides rules under which an eligible corporation may, by reason of a corporate transaction, substitute a new statutory option (new option) for an outstanding statutory option (old option) or assume an old option without such substitution or assumption being considered a modification of the old option.

Under section 1.424-1(a)(2) of the Regulations, the term "eligible corporation" means a corporation that is the employer of the optionee or a related corporation of such corporation. The determination of whether a corporation is the employer of the optionee or a related corporation of such corporation is based upon all of the relevant facts and circumstances existing immediately after the corporate transaction.

Under section 1.424-1(a)(3) of the Regulations, the term "corporate transaction" includes: (i) a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation; (ii) a distribution (excluding an ordinary dividend or a stock split or stock dividend described in section 1.424-1(e)(4)(v) of the Regulations) or change in the terms or number of outstanding shares of such corporation; and (iii) such other corporate events prescribed by the Commissioner in published guidance.

Section 1.424-1(a)(4) of the Regulations provides that, for a change in an option or issuance of a new option to qualify as a substitution or assumption, the change must be made by an eligible corporation and occur by reason of a corporate transaction. Section 1.424-1(a)(4) of the Regulations further provides that, generally, a change in an option or issuance of a new option is considered to be by reason of a corporate transaction, unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction.

Pursuant to section 1.424-1(a)(5) of the Regulations, for a change in an option or issuance of a new option to qualify as a substitution or assumption, the following requirements must be met:

(i) In the case of an issuance of a new option (or portion thereof) in exchange for an old option (or portion thereof), the optionee's rights under the old option (or portion thereof) must be canceled, and the optionee must lose all rights under the old option (or portion thereof). There cannot be a substitution of a new option for an old option within the meaning of section 1.424-1(a) of the Regulations if the optionee may exercise both the old option and the new option. It is not necessary to have a complete substitution of a new option for the old option. However, any portion of such option which is not substituted or assumed in a transaction to which section 1.424-1(a) of the Regulations applies is an outstanding option to purchase stock or, to the extent section 1.424-1(e) of the Regulations applies, a modified option.

(ii) The excess of the aggregate fair market value of the shares subject to the new or assumed option immediately after the change in the option or issuance of a new option over the aggregate option price of such shares must not exceed the excess of the aggregate fair market value of all shares subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option over the aggregate option price of such shares.

(iii) On a share by share comparison, the ratio of the option price to the fair market value of the shares subject to the option immediately after the change in the option or issuance of a new option must not be more favorable to the optionee than the ratio of the option price to the fair market value of the stock subject to the old option (or portion thereof) immediately before the change in the option or issuance of a new option. The number of shares subject to the new or assumed option may be adjusted to compensate for any change in the aggregate spread between the aggregate option price and the aggregate fair market value of the shares subject to the option immediately after the change in the option or issuance of the new option as compared to the aggregate spread between the option price and the aggregate fair market value of the shares subject to the option immediately before the change in the option or issuance of the new option.

(iv) The new or assumed option must contain all terms of the old option, except to the extent such terms are rendered inoperative by reason of the corporate transaction.

(v) The new option or assumed option must not give the optionee additional benefits that the optionee did not have under the old option.

Based on the information submitted, we rule that:

1. Section 83 of the Code does not apply to the Distributing or Controlled Non-Statutory Options that the holders of Corporation Non-Statutory Options received pursuant to the Share Distribution because those options did not have a readily ascertainable fair market value on the date the Share Distribution occurred. Section 83 will apply when those options are exercised or otherwise disposed of.
2. The exchange of Corporation ISOs for Distributing or Controlled ISOs pursuant to the Share Distribution will not constitute a modification, extension or renewal of these incentive stock options within the meaning of section 424(h)(3) of the Code, and therefore will not constitute the grant of new options for purposes of section 424 of the Code.
3. Provided the requirements of section 162 of the Code are satisfied, in the event that amounts are includible in the gross income of a holder of Distributing or Controlled Options under section 83 of the Code as a result of the exercise of such options, Distributing will be entitled to a corresponding deduction pursuant to section 83(h) of the Code if the employee was employed by or the director was a director of Distributing or a subsidiary of Distributing from the date the option was granted through the date of exercise (or any earlier termination of employment, where applicable), and Controlled will be entitled to a corresponding deduction pursuant to section 83(h) of the Code if the employee was employed by or the director was a director of Controlled or a subsidiary of Controlled from the date the option was granted through the date of exercise (or any earlier termination of employment, where applicable).

Except as specifically ruled on above, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed or implied regarding the qualification of the options under section 422 of the Code. Further, no opinion is expressed or implied regarding section 409A of the Code. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

KENNETH M. GRIFFIN
Senior Technician Reviewer
Executive Compensation Branch
Office of the Division Counsel/Associate Chief
Counsel (Tax Exempt and Government Entities)